Vol 311

FILED
SEP 27 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

No. 467

WM. CARNEGIE EWEN, LEWIS L. CLARKE, M. D. ADAMS and GEORGE E. WILE, as members of a duly constituted Income Bondholders' Protective Committee,

Petitioners,

against

THE PEORIA AND EASTERN RAILWAY COMPANY and DONALD N. GILBERT, HAROLD C. YEAGER and GEORGE A. CAREY, constituting the First Mortgage Bondholders' Protective Committee for The Peoria and Eastern Railway Company's First Consolidated Mortgage 4% Bonds due April 1, 1940,

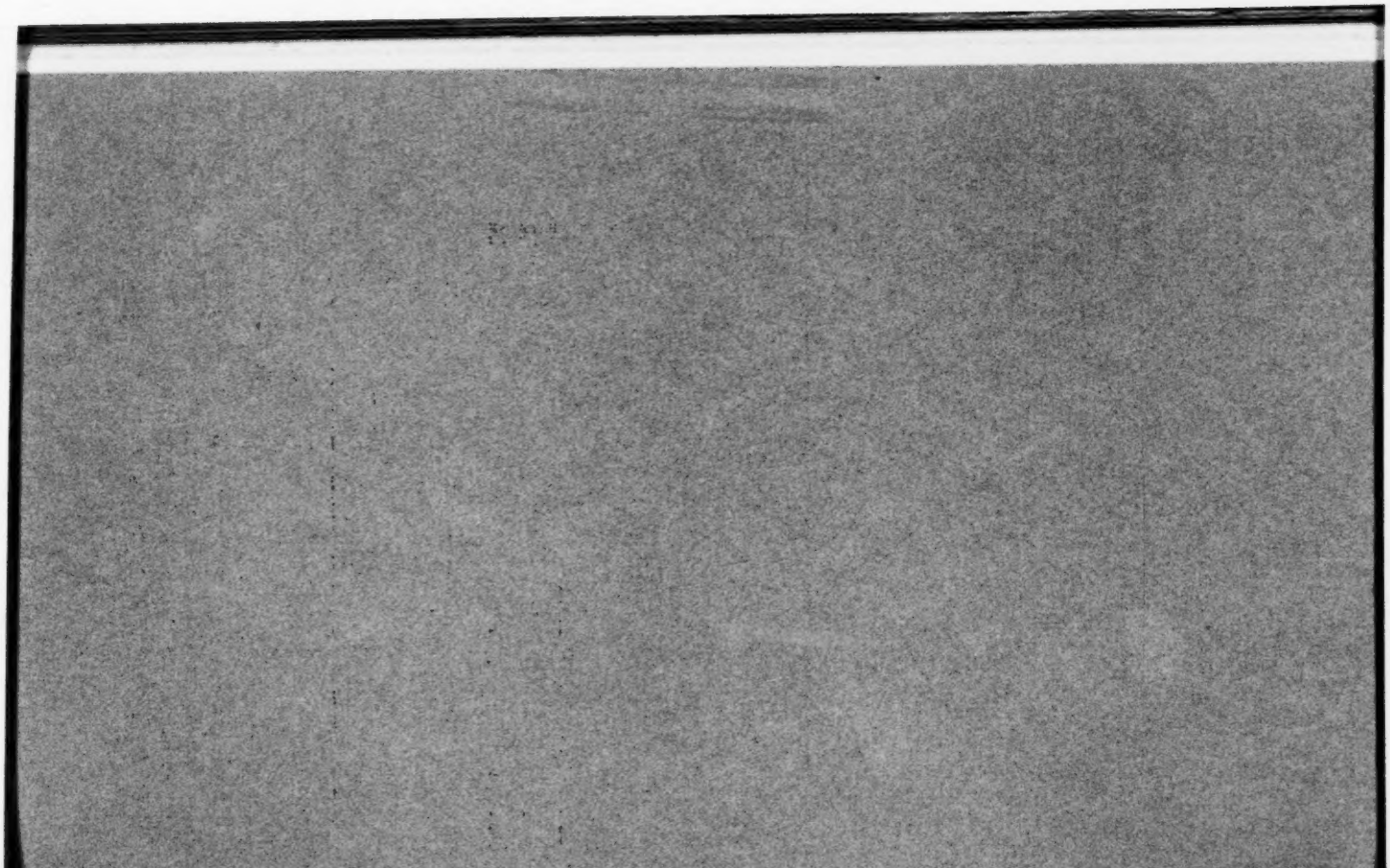
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK AND BRIEF IN SUPPORT THEREOF

AND

MOTION FOR DIMINUTION OF RECORD

CHARLES S. ARONSTAM,
Counsel to Petitioners.



SUBJECT INDEX.

PAGE

PETITION FOR WRIT OF CERTIORARI TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK 1

Jurisdiction 2

Summary Statement of the Matter Involved 3

Status of the Peoria Company on April 1, 1940. 6

Proceedings Before the Interstate Commerce Commission 7

Proceedings in the United States District Court 7

Plan of Adjustment 8

Questions Presented and Specification of Errors .. 9

Reasons Relied On for Allowance of Writ 10

Prayer 12

BRIEF 13

Opinion of the Court Below 13

Jurisdiction 14

Statement of Case 14

Specification of Errors 14

Argument 14

Summary of Argument 14

POINT A—The Special Court exceeded its jurisdiction as defined and prescribed in Section 700 of Chapter XV of the Bankruptcy Act in passing upon and approving the right of the New York Central and the Big Four to renew the Operating Agreement with the Peoria Company, in connection with the Plan of Adjustment for part of its mortgage indebtedness 16

POINT B—The Special Court erred in holding that, under the terms of the Operating Agreement, the New York Central and the Big Four had the in-

PAGE

alienable right to elect to continue said agreement for a further period of twenty years after its expiration on April 1, 1940..... 17

POINT C—The Special Court erred in holding that, under the terms of the Operating Agreement, the New York Central and the Big Four had the right to charge the Peoria Company for monies expended for the maintenance and operation of its properties in excess of its net earnings..... 22

POINT D—The Special Court erred in holding that the Income Bondholders were not adversely affected by the Plan of Adjustment in accordance with Section 706 of Chapter XV of the Bankruptcy Act, and that by reason thereof their written consent to the said Plan was not necessary... 25

POINT E—The Special Court erred in finding that the Plan was fair and equitable as an adjustment; afforded due recognition and fair consideration to the Income Bondholders; and conformed to the law of the land regarding the participation of the various classes of creditors..... 26

POINT F—The Special Court erred in drawing inferences of fact, giving consideration to and being influenced by the threats of the New York Central that, in the event the Plan were not approved, it would withdraw its deposit of $5,000,000 in satisfaction of the Purchase Money Lien on the Springfield Division and would re-route its traffic therefrom over other lines, which would result in inevitable bankruptcy for the Peoria Company..... 28

APPENDIX A—OPERATING AGREEMENT..... 31

APPENDIX B—OPINION OF SPECIAL COURT..... 39

MOTION WITH RESPECT TO RECORD ON APPEAL..... 51

TABLE OF CASES CITED.

PAGE

Baltimore & Ohio Railway Company, In the Matter of, 29 Fed. Supp. 608 16
Becker v. Frassee & Co., 255 N. Y. 10 24
Case v. Los Angeles Lumber Co., Ltd., 308 U. S. 106 ...27, 29
Delashmutt v. Thomas, 45 Md. 140 20
Gaswell Service, Inc. v. Sinclair Refining Co., 240 App. Div. (N. Y.) 240 19
Gillette v. Bank of America, 160 N. Y. 549 24
Howard v. Tomicick, 81 Miss. 703 19
Idalia Realty Development Co. v. Norman, 232 Mo. 663. 20
O'Reilly v. Frye, 263 Mass. 318 19
Pidgeon v. Richards, 4 Ind. 374 19
Say v. Smith, 1 Plowden 269 20
Western Transportation Co. v. Lansing, 49 N. Y. 499 .. 18, 19, 20

TABLE OF STATUTES CITED.

Bankruptcy Act—Chapter XV:
Section 700 (Title II, U. S. C. A., § 1200) 14, 16, 17
Section 706 (Title II, U. S. C. A., § 1206) 9, 15, 25
Section 710 (Title II, U. S. C. A., § 1210) 7, 26
Section 713 (Title II, U. S. C. A., § 1213) 2
Section 725 (Title II, U. S. C. A., § 1225) 26, 27
Section 745 (Title II, U. S. C. A., § 1245) 2, 11

Interstate Commerce Act:
Section 5(4) 7

Judicial Code:
Section 266, as amended 2

TREATISE CITED.

Williston, Contracts, Rev. Ed., Vol. 1, §43 20

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

No.

WM. CARNEGIE EWEN, LEWIS L. CLARKE, M. D. ADAMS and GEORGE E. WILE, as members of a duly constituted Income Bondholders' Protective Committee,

Petitioners,

against

THE PEORIA AND EASTERN RAILWAY COMPANY and DONALD N. GILBERT, HAROLD C. YEAGER and GEORGE A. CAREY, constituting the First Mortgage Bondholders' Protective Committee for The Peoria and Eastern Railway Company's First Consolidated Mortgage 4% Bonds due April 1, 1940,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners respectfully show to the Court as follows:

Petitioners Wm. Carnegie Ewen, Lewis L. Clarke and M. D. Adams were duly appointed by the holders of Income

Bonds of the Peoria and Eastern Railway Company as a Protective Committee to represent their interests in these proceedings. Petitioner George E. Wile, the owner of $114,000 of said Income Bonds, subsequently became a member of said Committee.

This is a petition for a writ of certiorari to review the decree made and entered on the 29th day of July, 1940, of the District Court of the United States for the Southern District of New York, sitting as a Special Court of three Judges, consisting of Learned J. Hand, Circuit Court Judge, John M. Woolsey and Murray Hulbert, District Court Judges, convened pursuant to Section 713 of Chapter XV of the Bankruptcy Act in the manner provided by Section 266, as amended, of the Judicial Code, approving, as modified by the Special Court,* a Plan of Adjustment under Chapter XV of the Bankruptcy Act for the extension of the date of maturity from April 1, 1940, to April 1, 1960, of a part of the principal of the First Consolidated Mortgage Bonds of the Peoria and Eastern Railway Company and *for the renewal and modification of the Operating Agreement between the Peoria and Eastern Railway Company and the Cleveland, Cincinnati, Chicago and St. Louis Railway Company* which expired on April 1, 1940.

Jurisdiction.

The decree of the Special Court to be reviewed was entered on July 29, 1940.

The jurisdiction of this Court is invoked under Section 745 of Chapter XV of the Bankruptcy Act (Title II, U. S. C. A., §1245).

Note: A motion is made herewith for the diminution of the record; consequently references in this petition and brief are to the original exhibits and other documents.

* The Plan of Adjustment was modified so as to provide that the Income Bondholders shall, so long as the Income Bonds remain unpaid, have one director upon the Board of Directors.

Summary Statement of the Matter Involved.

The Peoria and Eastern Railway Company (hereinafter referred to as the "Peoria Company") was organized on February 20, 1890, to acquire certain railroad properties formerly of the Ohio, Indiana and Western Railway Company (hereinafter referred to as the "Ohio Company") which owned a line of railroad extending from Pekin, Illinois, through Indianapolis, Indiana, to Springfield, Ohio, of approximately 337 miles which was then in foreclosure. Prior to the foreclosure proceedings a plan of reorganization was formulated by and under the supervision of the Cleveland, Cincinnati, Chicago & St. Louis Railway Company (hereinafter referred to as the "Big Four").

The plan of reorganization of the Ohio Company was effectuated in the following manner:

1. The portion of the railroad extending from Pekin, Illinois, to Indianapolis, Indiana, of approximately 201 miles, was conveyed to the Peoria Company, subject to two mortgages aggregating $1,500,000 (hereinafter referred to as "prior liens").

2. The portion of the railroad extending from Indianapolis, Indiana, to Springfield, Ohio (hereinafter referred to as the "Springfield Division"), of approximately 136 miles, was conveyed to the Big Four for and in consideration of the sum of $5,000,000 represented by a Purchase Money Lien in that amount maturing on April 1, 1940, and bearing interest at 4%, which Purchase Money Lien was thereafter transferred to and became the property of the Peoria Company.

3. For the foregoing properties, including the Purchase Money Lien, the Peoria Company issued the following securities:

(a) $7,930,000 of First Consolidated Mortgage Bonds out of an authorized issue of $10,000,000, bearing interest at 4%, maturing on April 1, 1940;

(b) $4,000,000 of Income Mortgage Bonds bearing interest at the rate of 4% per annum, which was to be non-accumulative and payable only out of the net earnings and income of the Peoria Company, maturing on April 1, 1990;

(c) 100,000 shares of capital stock of the Peoria Company of the par value of $100 each, of which 50,000 shares were given to the Big Four, which subsequently acquired by purchase an additional share of stock. The balance of the shares of stock, together with the First Consolidated Bonds and Income Bonds, were distributed among the former security holders of the Ohio Company.

4. The Big Four and the Peoria Company entered into an agreement granting to the Big Four the exclusive and absolute right to use and operate the properties of the Peoria Company for a period of fifty years from April 1, 1890, to April 1, 1940, *"and for such further time thereafter as it may elect."* This agreement* (hereinafter referred to as the "Operating Agreement") provides as follows:

> (a) The Big Four shall *at its own cost and expense* furnish all rolling stock, equipment, repairs and supplies necessary to operate the railroad; keep and maintain said line, rolling stock and equipment in good working order; restore and renew all parts; pay all taxes; and *indemnify and save harmless the Peoria Company from any and all claims arising out of its operation and management* (Par. First, Appendix A, p. 33).
>
> (b) The Big Four shall provide and make good any deficiency in the fund necessary to pay interest on the prior bonds and on the First Consolidated Bonds and guarantees that the net earnings and the income of the Peoria Company operated by *it* shall be not less than $412,200 per annum (Par. Second, Appendix A, p. 34).

---

*The Operating Agreement (Exhibit 26) is printed as Appendix A hereto, page 31.

(c) The Big Four shall receive all the earnings and income from the use and operation of the Peoria Company's properties. The net earnings derived therefrom, after deducting operating expenses, to be applied, first, to the payment of interest on the prior liens and the First Consolidated Bonds; second, to reimburse the Big Four for any advances made under the Operating Agreement in any previous year; third, apply the balance to the payment of interest on the Income Mortgage Bonds; and fourth, to pay any amount finally remaining to the Peoria Company (Par. Third, Appendix A, p. 35).

(d) The Big Four shall look *only to the future net earnings of the line operated by it* and to the income from the Purchase Money Lien for reimbursement to it of any sums which it may advance in compliance with its guarantee (Par. Fifth, Appendix A, p. 37).

All the documents, agreements, etc., embodying the foregoing, were simultaneously executed on February 22, 1890.

On February 25, 1890 (three days after the documents were executed), the then President of the Big Four, M. E. Ingalls, summarized the transaction between the two companies as follows:

> "The general result of all these papers was that this Company (the Big Four) acquires the ownership or is granted the lease or right to operate all the railway property formerly of the O. I. & W. Railway Company at a net rental of $412,200" (Exhibit O).

Thus the Big Four obtained complete control of the railway properties formerly of the Ohio Company and by reason of its acquisition of 50,001 shares of the capital stock of the Peoria Company obtained complete control and domination of the affairs and management of the Peoria Company, its lessor.

Subsequently, by lease dated January 22, 1930, the Big Four leased to the New York Central, for the term of ninety-

nine years, all its lines of railroad and other properties, and transferred to the New York Central its rights under the Operating Agreement, and the New York Central assumed the obligations thereunder. The New York Central owns 96% of the stock of the Big Four.*

The Peoria Company, the Big Four and the New York Central have common directors, officers and counsel. The Peoria Company was not independently represented in these proceedings except in so far as the officers and counsel of the Big Four and the New York Central purported to represent the Company.**

Status of the Peoria Company on April 1, 1940.

1. The $5,000,000 Purchase Money Lien on the Springfield Division became due and payable by the Big Four to the Peoria Company.

2. The prior liens of the Peoria Company aggregating $1,346,000 became due and payable.

3. The First Consolidated Bonds of the Peoria Company aggregating $8,376,000 became due and payable.

4. The term specifically set forth in the Operating Agreement expired. The New York Central and the Big Four claimed there was due and owing to them on account of advances made under said agreement the sum of $2,485,482.58.†

5. Acting on the assumption that it had the inalienable right to renew the Operating Agreement for a further term, the Big Four with the New York Central, on March 30, 1940, addressed a letter (Exhibit 49)†† to the Peoria Company

---

* The foregoing history is set forth in Findings of Special Court Nos. 1 to 19, incl.

** The Special Court recognized the dual and conflicting relationship between the three companies and the possibility of abuse therefrom, and by reason thereof provided in its decree that the Income Bondholders were to have one director on the Board of Directors.

† Of this sum, $1,806,493.18 represents maintenance, additions and betterments, $522,517.24 represents accrued interest and $11,006.02 represents interest paid on funded debt (Exhibit I, Findings of Special Court No. 27).

†† Findings of Special Court No. 33.

(which it controlled) electing to renew the Operating Agreement from April 1, 1940, to April 1, 1960.

6. The Peoria Company had no funds to meet its maturities except from the proceeds of the $5,000,000 Purchase Money Lien.

RESULT: For forty out of the fifty years of the operation of the Peoria Company's properties under the Operating Agreement by the Big Four, the Income Bondholders received no interest on their bonds.

Proceedings Before the Interstate Commerce Commission.

On January 25, 1940, the Peoria Company applied to the Interstate Commerce Commission, pursuant to Chapter XV of the Bankruptcy Act, for authority to modify its First Consolidated Bonds, by making a cash payment of 45% thereof and by extending the maturity date for twenty years from April 1, 1940, of the unpaid principal amount with interest at the existing rate of 4% per annum.

On February 3, 1940, in a separate proceeding, the Big Four and the New York Central applied to the Commission under Section 5(4) of the Interstate Commerce Act for (1) approval and authority to renew the Operating Agreement from April 1, 1940, to April 1, 1960, with certain modifications (Exhibit 33); and (2) for authority to assume obligation and liability in respect to the interest on $4,722,300 reduced principal amount of the extended First Consolidated Bonds.

The decision of the Commission approving both applications was predicated upon the assumption, and so recorded in its decision, that there was no opposition to the Plan of Adjustment and to the renewal of the Operating Agreement.

Proceedings in the United States District Court.

Thereafter, in pursuance of the provisions of Section 710 of Chapter XV, the Peoria Company applied to the District Court for approval and confirmation of the Plan of Adjustment.

This Court fixed the date for hearing on said Plan of Adjustment for April 29, 1940, at which time petitioners applied for intervention in the proceedings. The application was granted and an order of intervention was duly made and entered on May 8, 1940. The Peoria Company did not solicit the written consents of the Income Bondholders to the Plan of Adjustment and the renewal of the Operating Agreement, and such consents were not secured.

Plan of Adjustment.

The Plan of Adjustment, as set forth in Exhibit 5, provides that:

(1) Upon the Plan becoming effective, the Big Four would pay the $5,000,000 * Purchase Money Lien on the Springfield Division, to be applied to the liquidation of the outstanding prior liens, and the balance on account of the First Consolidated Bonds which matured on April 1, 1940, reducing the unpaid principal to $4,722,300. These bonds as reduced to be extended to April 1, 1960, with interest at the rate of 4%.

(2) The continued use and operation of the Peoria Company's properties by the New York Central and the Big Four from April 1, 1940, to April 1, 1960, pursuant to the right of election of the Big Four as contained in the Operating Agreement with certain modifications.†

(3) The advances which have been made by the Big Four and the New York Central to the Peoria Company under the Operating Agreement (amounting as of December 31, 1939, to $2,485,482.58) to continue their existing status under the Operating Agreement as a prior lien to the Income Bonds.

* This $5,000,000 has since been paid and applied to the satisfaction of the prior liens and to the reduction of the First Consolidated Bonds as proposed in the Plan.

† The agreement evidencing the extension provides that the guarantee of the Big Four with respect to net earnings shall be reduced from $412,200 to an amount sufficient only to pay interest on the First Consolidated Bonds as reduced ($188,892), and that all expenses in connection with equipment, additions and betterments shall be borne by the Peoria Company (Exhibit 33).

(4) The holders of the Income Mortgage Bonds of the Peoria Company to continue their status under the Income Mortgage, subject to the First Consolidated Mortgage Bonds as modified and extended, and to the Operating Agreement as extended.

Questions Presented and Specification of Errors.

1. The Special Court erred in exceeding its power and authority under Chapter XV of the Bankruptcy Act in passing upon and considering as a part of the Plan of Adjustment of the First Consolidated Mortgage Bonds the right of the Big Four to a renewal of the Operating Agreement.

2. The Special Court erred in construing the provision in the Operating Agreement that *"the Cleveland Company (the Big Four) shall and will henceforth and during the period of fifty years from April 1, 1890, and for such further time thereafter as it may elect"* gave to the New York Central and the Big Four the right to renew the Operating Agreement for a specified term of twenty years in the light of the settled law that such provisions are of no force and effect in law by reason of uncertainty.

3. The Special Court erred in holding that the Big Four had a right to charge the Peoria Company for advances made for the maintenance and operation of the Company's properties in excess of the Company's net earnings, in that the Operating Agreement specifically provided that the Big Four would *at its own cost and expense* furnish all rolling stock, equipment, repairs and supplies necessary to operate the railroad and keep and maintain the *same in good order and save the Peoria Company free and harmless from any and all claims arising out of its operation and management.*

4. The Special Court erred in holding that the Income Bondholders were not adversely affected by the Plan of Adjustment in accordance with Section 706 of Chapter XV of the Bankruptcy Act insofar as said Plan provided for the extension of the Operating Agreement for a specified term

of twenty years and the continuance of the non-negotiable unsecured inter-company debt of $2,485,482.58 as a prior obligation to the Income Bonds.

5. The Special Court erred in drawing inferences of fact and being influenced in its decision by the threats of the New York Central that, in the event the Plan were not approved, including the extension of the Operating Agreement, it would probably withdraw its deposit of $5,000,000 for the satisfaction of the Purchase Money Lien on the Springfield Division, resulting in the foreclosure of the property, and would divert its traffic therefrom over its other lines, resulting in inevitable bankuptcy of the Peoria Company, when in truth and in fact the New York Central never intended to default on the Purchase Money Lien and has since paid the same.

6. The Special Court erred in disregarding the dual and conflicting relationship existing between the Big Four and the Peoria Company in construing the Operating Agreement more favorably to the Big Four than the construction placed upon said agreement by the Big Four at the time it was made.

7. The Special Court erred in finding that the Plan was fair and equitable as an adjustment, afforded due recognition and fair consideration to the Income Bondholders, and conformed to the law of the land regarding the participation of the various classes of creditors.

Reasons for Allowance of Writ.

1. The Special Court has so disregarded the statutory prohibitions limiting its jurisdiction, has so completely ignored the well settled and established rules of law, and has so far departed from the accepted course of judicial proceedings as to call for an exercise of this Court's power of supervision.

a. The Special Court construed the terms and provisions of the Operating Agreement contrary to well-established rules of law.

b. The Special Court allowed itself to be improperly swayed and influenced by the threats of the New York Central that, if the Plan of Adjustment were not approved and the Operating Agreement renewed, the $5,000,000 Purchase Money Lien would not be paid by the Big Four, the Springfield Division would revert to the Peoria Company, and its traffic would be diverted therefrom to other lines operated by the New York Central, resulting in inevitable bankruptcy for the Peoria Company.

2. The Income Bondholders were adversely affected by the Plan of Adjustment and their consent should have been secured thereto in the manner provided in Chapter XV of the Bankruptcy Act.

3. This is the first review from the decree of the Special Court and the only method allowed under Section 745 of Chapter XV of the Bankruptcy Act and, if this petition is denied, the Income Bondholders will not have been afforded any opportunity for a review of the decree of the Special Court.

4. If this petition is denied, the Income Bondholders will be barred from ever contesting the right of the Big Four to extend the Operating Agreement for a period of twenty years and the termination of the claim of the Big Four for its alleged advances, which advances would otherwise be extinguished with the expiration of the Operating Agreement, thus permanently impairing the security of the Income Bonds and precluding the payment of interest thereon for a further period of twenty years.

Prayer for Writ.

WHEREFORE, petitioners respectfully pray that a writ of certiorari be issued under the seal of this Court, directed to the District Court of the United States for the Southern District of New York, to the end that this cause may be reviewed and determined by this Court and the decree of the District Court of the United States may be reversed, and that petitioners may have such other and further relief as this Court may deem proper in the premises.

Dated: New York City, September 25, 1940.

WM. CARNEGIE EWEN, LEWIS L. CLARKE, M. D. ADAMS and GEORGE E. WILE, as members of a duly constituted Income Bondholders' Protective Committee,

By CHARLES S. ARONSTAM,
Counsel.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

No.

WM. CARNEGIE EWEN, LEWIS L. CLARKE, M. D. ADAMS and GEORGE E. WILE, as members of a duly constituted Income Bondholders' Protective Committee,

Petitioners,

against

THE PEORIA AND EASTERN RAILWAY COMPANY and DONALD N. GILBERT, HAROLD C. YEAGER and GEORGE A. CAREY, constituting the First Mortgage Bondholders' Protective Committee for The Peoria and Eastern Railway Company's First Consolidated Mortgage 4% Bonds due April 1, 1940,

Respondents.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I

The Opinion of the Court Below.

The opinion of the Special Court of the United States District Court for the Southern District of New York has not yet been officially reported. It is printed as Appendix B hereto at page 39.

II

Jurisdiction.

The statement of jurisdiction is contained in the petition for certiorari and by reason thereof is not repeated here.

III

Statement of the Case.

The statement of the facts is contained in the petition for certiorari and by reason thereof is not repeated here.

IV

Specification of Errors.

The specification of errors are contained in the petition for certiorari and by reason thereof are not repeated here.

ARGUMENT

Summary of Argument.

POINT A. The Special Court exceeded its jurisdiction as defined and prescribed in Section 700 of Chapter XV of the Bankruptcy Act in passing upon and approving the right of the New York Central and the Big Four to renew the Operating Agreement with the Peoria Company, in connection with the Plan of Adjustment for part of its mortgage indebtedness.

POINT B. The Special Court erred in holding that, under the terms of the Operating Agreement, the New York Central and the Big Four had the inalienable right to elect to continue said Agreement for a further period of twenty years after its expiration on April 1, 1940.

POINT C. The Special Court erred in holding that, under the terms of the Operating Agreement, the New York Central and the Big Four had the right to charge the Peoria Company for monies expended for the maintenance and operation of its properties in excess of its net earnings.

POINT D. The Special Court erred in holding that the Income Bondholders were not adversely affected by the Plan of Adjustment in accordance with Section 706 of Chapter XV of the Bankruptcy Act, and that by reason thereof their written consent to the said Plan was not necessary.

POINT E. The Special Court erred in finding that the Plan was fair and equitable as an adjustment, afforded due recognition and fair consideration to the Income Bondholders, and conformed to the law of the land regarding the participation of the various classes of creditors.

POINT F. The Special Court erred in drawing inferences of fact, giving consideration to and being influenced by the threats of the New York Central that, in the event the Plan were not approved, it would withdraw its deposit of $5,000,000 in satisfaction of the Purchase Money Lien on the Springfield Division and would re-route its traffic therefrom over other lines, which would result in inevitable bankruptcy for the Peoria Company.

POINT A

The Special Court exceeded its jurisdiction as defined and prescribed in Section 700 of Chapter XV of the Bankruptcy Act in passing upon and approving the right of the New York Central and the Big Four to renew the Operating Agreement with the Peoria Company, in connection with the Plan of Adjustment for part of its mortgage indebtedness.

Section 700 of Chapter XV provides as follows:

> "Sec. 700. In addition to the jurisdiction otherwise exercised, courts of bankruptcy shall exercise original jurisdiction, as provided in this chapter, for postponements or modifications of debt, interest, rent, and maturities or for modifications of the securities or capital structures of railroads."

The Income Bondholders do not object to the Plan of Adjustment insofar as it provides for the application of the $5,000,000 received in satisfaction of the Purchase Money Lien on the Springfield Division from the Big Four, toward the payment of the prior liens and the reduction and extension of the respondent's First Consolidated Bonds in the manner provided for in the Plan, but they do object to that portion of the Plan which makes the renewal and modification of the Operating Agreement *conditio sine qua non* to the payment of said monies by the Big Four.

Chapter XV of the Bankruptcy Act did not intend nor contemplate the extension of the jurisdiction of the Special Courts convened thereunder to inquire into or pass upon any question except the adjustment of a railroad's capital structure.

Judge Chestnut in *In re Baltimore & Ohio Railroad Company*, 29 Fed. Supp. 608, states as follows with respect to the purposes of Chapter XV:

> "Other provisions of the Act indicate quite clearly that its purpose is to provide relief for railroads which

> are only temporarily financially embarrassed and whose general earning capacity has not been so seriously impaired as to require the more drastic reorganization and modification of its debt structure provided for in Section 77 of the Bankruptcy Act" (p. 612).

In the instant case the Peoria Company in its Plan of Adjustment sought, in addition to an adjustment of its First Consolidated Bonded indebtedness, the approval and sanction for a renewal of an operating agreement with the New York Central and the Big Four which does not come within the limitations prescribed in Section 700 of Chapter XV.

POINT B

The Special Court erred in holding that, under the terms of the Operating Agreement, the New York Central and the Big Four had the inalienable right to elect to continue said agreement for a further period of twenty years after its expiration on April 1, 1940.

The provision contained in the Operating Agreement for its renewal is invalid for uncertainty and is of no force or effect.

Paragraph First of the Opening Agreement, among other things, provides:

> "* * * the Cleveland Co. shall and will henceforth and during the period of fifty years from April 1st, 1890, *and for such further time thereafter as it may elect*, use and operate said 'Indiana part' and said 'Illinois part' as railways * * *" (Appendix A, p. 33). (Italics ours.)

Acting upon the assumption that it had the inalienable right to renew the Operating Agreement for such further term as it may elect, the Big Four, jointly with the New York Central, addressed a letter (Exhibit 49)* to the Peoria Com-

* Findings of Special Court No. 33.

pany, exercising said election. The letter advises the Peoria Company that, upon the proposed Plan of Adjustment, or a modification thereof, becoming effective, the Big Four will enter into an extension agreement with the Peoria Company evidencing said election from April 1, 1940 to April 1, 1960.

The State Courts have uniformly held that such provisions as contained in the Operating Agreement for a renewal and/or extension have no legal effect by reason of their uncertainty.

In *Western Transportation Co.* v. *Lansing,* 49 N. Y. 499, an action was brought upon a similar covenant in a lease. The lease was for a term of fifteen years and contained the following provision:

> "with privilege of keeping and occupying said lots *for such further time, after the expiration of said term, as said party of the second part* (*lessee*) *shall choose or elect*" (p. 500). (Italics ours.)

At the termination of the lease the tenant demanded a lease for a further term of fifteen years, and, upon being refused, sued for specific performance.

The Court said:

> "Thus considered we have a provision for further occupation, which by its terms definitely settles the amount of the rent, and, to an extent, the time for the payment of it; but by placing the length of time of such further occupation in the choice or election of the lessee, leaves it, *a priori,* entirely uncertain and indeterminate; and which precludes the implication from the provisions of the lease of anything as to these matters" (p. 504).
>
> * * * * * *
>
> "If we treat these provisions as a covenant on the part of the lessor for a new lease, the question arises, is it valid and enforceable, or is it void for uncertainty; specific performance of which may not be adjudged? It has been held that where no term is fixed by the covenant, it is void for uncertainty (*Abeel* v. *Radcliff,* 13 J. R. 296)" (p. 504).

The doctrine enunciated in *Western Transportation Co.* v. *Lansing, supra,* was approved and followed in *Gaswell Service, Inc.* v. *Sinclair Refining Co.*, 240 App. Div. (New York) 240.

In *Howard* v. *Tomicick*, 81 Miss. 703, a lease was made for one year with the clause "with privilege of longer."

The Court said at page 708:

> "The question is whether a lease of premises of one year 'with privilege of longer,' secures to the lessee right of renewal of the lease at his option. We think it does not. It is too vague and uncertain to constitute a binding covenant."

In *O'Reilly* v. *Frye*, 263 Mass. 318, the Court said:

> "The agreement of the parties made the term of the tenancy determinable at the will of the lessee. Such a tenancy 'must, in law, be at the will of both parties'" (citing cases) (p. 320).

In *Pidgeon* v. *Richards*, 4 Ind. 374, the Court had before it the following clause "to occupy so long as he desires":

> "The substance of that instrument is, that it gives to *Richards* the right to occupy and improve the land in question for a certain consideration, payable as he occupies, as long as he shall please to do so. It gives him no absolute interest which he can convey to another on vacating the premises himself. Whenever he removes from them, his right in them ceases. And he is not bound to occupy them and pay the consideration a day longer than he sees fit to do so. He has, in short, under the instrument, an estate in the land at his own will. Such being the character of the instrument, the case is easily disposed of.
>
> Lord *Coke*, in his first Inst., 55*a*, says: 'It is regularly true, that every lease at will must in law be at the will of both parties, and, therefore, when the lease is made, to have and to hold at the will of the lessor, the law implyeth it to be at the will of the lessee also; for it cannot be onely at the will of the lessor, but it must be at the will of the lessee also. And so

> it is when the lease is made to have and to hold at the will of the lessee, this must be also at the will of the lessor, and so are all the bookes that seeme *prima facie* to differ, clearly reconciled.'
>
> This law of Lord *Coke's* day continues to be the law of the present day" (pp. 375, 376).

See also:

> * *Idalia Realty Development Co.* v. *Norman*, 232 Mo. 663;
>
> *Delashmutt* v. *Thomas*, 45 Md. 140.

Williston on Contracts, Rev. Ed., Vol. 1, states as follows:

> "§43. One of the commonest kind of promises too indefinite for legal enforcement is where the promisor retains an unlimited right to decide later the nature or extent of his performance. This unlimited choice in effect destroys the promise and makes it merely illusory" (p. 123).

There is nothing in the Operating Agreement which specified or made certain the terms and conditions upon which the agreement was to be continued, *or the term for which the Big Four was to enjoy a further occupation after the original term expired.* The Special Court in its opinion, despite the foregoing authorities, construed the clause in the Operating Agreement "as giving the 'Big Four' an option pending the term to extend it for a specified period in the future. (Whether more than one such extension was contemplated we need not decide.)" In support of its contention the Special Court cited *Say* v. *Smith*, 1 Plowden 269 (Appendix B, p. 42).

In *Western Transportation Co.* v. *Lansing, supra,* the Court discussed *Say* v. *Smith, supra,* and held that said case was not applicable to the provision under discussion, which is similar in all respects to the language employed in the Operating Agreement.

> "Now it may not seem that in principle, there is any distinction between a contract for a lease for so many

* This case cited and approved *Western Transportation Co.* v. *Lansing*, 49 N. Y. 499.

years as I. S. shall name, and one for so many years as the lessee shall name. It may be that there is not. We are not here called upon to say how it is. The clause in the contract before us does not provide to that effect. *By it the occupation is not for such further time after the expiration of the first term as the lessee shall name. He is not by it before or when he begins that occupation to name and specify the number of years for which he will continue as tenant. But the occupation is to run along without a determined continuance specified beforehand; and is for its duration, dependent all the while upon his choice or election, unexpressed as to a definite term thereof, so that it may continue indefinitely, and be arrested whenever he wills.* * * *" (p. 508). (Italics ours.)

The opinion of the Special Court holding that the Big Four had the right to renew the Operating Agreement for a period of twenty years is contrary to and disregards the settled law as enunciated in the foregoing cases. Counsel has found no decision in the State courts sustaining the Court's reasoning nor was counsel for the Peoria Company in the proceedings before the Special Court able to cite any authority to sustain the right of the Big Four to elect to renew the Operating Agreement for twenty years.

*If the Operating Agreement expired on April 1, 1940, then simultaneously therewith the advances alleged to have been made by the New York Central and the Big Four thereunder in the sum of $2,485,482.58 became extinguished.** The Spe-

* Paragraph Fifth of the Operating Agreement provides:

"FIFTH.—The Cleveland Co. shall and will look *only* to such *future net earnings of said lines of railroad operated by it* under these presents and such future income of said purchase money lien, as shall not be required for the payment of said interest on said prior bonds and on said First Consolidated Mortgage Bonds, and hereinabove guaranteed by it, *for the reimbursement to it* of any sums it may advance in compliance with its aforesaid covenants and agreements, and the Peoria Co. hereby charges all such future net earnings and income coming to it, its successors or assigns, not required for the payment of said interest, with the payment of all such advances of the Cleveland Co., with interest upon said advances at the rate of six per cent. per annum" (Appendix A, p. 37). (Italics ours.)

cial Court concurred in this view in its opinion: "It is true that by so doing the New York Central will be able to recoup for its past advances out of future income, a privilege which would have otherwise ended on April 1, 1940" (Appendix B, p. 42).

POINT C

The Special Court erred in holding that, under the terms of the Operating Agreement, the New York Central and the Big Four had the right to charge the Peoria Company for monies expended for the maintenance and operation of its properties in excess of its net earnings.

Under the Operating Agreement, the Peoria Company granted to the Big Four: (1) *the exclusive right to use and operate all of its properties* (Par. First); (2) the right to receive all the earnings and income derived from the Peoria Company's properties operated by it (Par. Third).

In return for the foregoing privileges, the Big Four agreed *at its own cost and expense:* to keep and maintain said railroad in good working order; pay all taxes and indemnify and save harmless the Peoria Company from any and all claims arising out of its operation and management (Par. First). The Big Four further *agreed to provide and make good any deficiency* necessary to pay interest on the prior bonds and on the First Consolidated Bonds and guaranteed that the net earnings and the income of the Peoria Company would not be less than $412,200 per annum (Par. Second).

It is now claimed that, as of December 31, 1939, the respondent is indebted to the New York Central and the Big Four in the sum of $2,485,482.58, of which $1,806,493.18 represents maintenance and additions-betterments and $552,517.24 represents accrued interest thereon (Exhibit 1).*

The provision of paragraph Third of the Operating Agreement, upon which the Big Four relies for reimbursement, in no way nullifies the specific provisions of paragraph First.

* Findings of Special Court No. 27.

Reference in paragraph Third to the sources of the company's earnings, the formula to determine the net income and its application, was intended solely as a measuring rod to ascertain the net income of the Peoria Company and the amount of the advances, if any, to be supplied by the Big Four on account of interest on the prior bonds and First Consolidated Bonds.

The agreement entered into between the Reorganization Committee of the Ohio Company and the Big Four on the 30th day of October, 1889 (Exhibit S), excludes any other construction than that advanced by the Income Bondholders. In that agreement the Big Four undertook to:

> "guarantee that the net earnings and income of the Western Company (Peoria Company) derived from both said lines shall not be less than $412,200 a year, to be increased by the sum of $40 a year for each and every of said First Consolidated Mortgage Bonds issued in excess of $9,430,000 of said bonds, as provided in said plan of reorganization, and that the Cleveland Co. *shall look only to future surplus net earnings and income of the Western Company derived from both said lines for its reimbursement of any sums advanced to make good any deficiency in said net earnings and income, with interest at six per cent. per annum.*" (Italics ours.)

And it further undertook to:

> "maintain said Western line (Peoria Company) and the rolling stock necessary for the operation of said Western line, and pay all taxes thereon, or upon the earnings or income of said Western line, as well as rentals or other like charges, and to indemnify and save harmless said Western Company from all claims arising out of the operation or management thereof."

Although provision was made for reimbursement to the Big Four on account of the advances to make good any deficiency in the net earnings of the Peoria Company, *no provision was made for reimbursement on account of the Big Four's undertaking to maintain the Peoria Company's properties.*

The statement of the President of the Big Four, made to his Board of Directors on February 25, 1890, three days after the execution of the Operating Agreement, further supports the Income Bondholders' construction.

> "* * * the general result of all these papers was that this Company (the Big Four) acquires the ownership or is granted the lease or right to operate all the railway property formerly of the O. I. & W. Railway Company at a net rental of $412,200" (Exhibit O).

The language of an instrument is to be construed against the person who proposes it rather than the person who is invited to accept it. The interpretation by the President of the Big Four of all the instruments executed on February 22, 1890, including the Operating Agreement, should be the standard of interpretation to be adopted by the Court. See *Gillette* v. *Bank of America*, 160 N. Y. 549, at page 555. The foregoing principle was reaffirmed by Judge Cardozo in the case of *Becker* v. *Frassee & Co.*, 255 N. Y. 10, at page 14.

Thus, the Special Court in its opinion erred in stating,

> "All we now hold is that the covenant to maintain the road and to make additions to its equipment, did not contemplate gratuitous advances, and that the third article allowed recoupment for so much as was properly expended" (Appendix B, p. 45).

In its decree the Special Court attempted to meet the objections raised by both Bondholders' Protective Committees as to the validity of these advances by providing:

> "Section 24. All questions concerning the amount and validity of the accounts between the Big Four, the New York Central Railroad Company and the Petitioner are not determined in these proceedings and are hereby specifically left open and reserved for future determination. Should the New York Central Railroad Company and/or the Big Four seek or attempt, in any year or at any time or times hereafter, to withdraw any part of the earnings or assets of the

Petitioner by way of recoupment or repayment of said inter-company accounts, then and in such event said New York Central Railroad Company and/or Big Four must prove and establish their right to do so" (Decree, p. 10).

This provision, however, does not meet the objection that these advances had no legal basis in fact or in law and were extinguished with the expiration of the Operating Agreement.

POINT D

The Special Court erred in holding that the Income Bondholders were not adversely affected by the Plan of Adjustment in accordance with Section 706 of Chapter XV of the Bankruptcy Act, and that by reason thereof their written consent to the said Plan was not necessary.

Section 706 of Chapter XV of the Bankruptcy Act reads as follows:

> "SEC. 706. No creditor shall be deemed to be 'affected' by any plan unless such plan proposes a modification of the evidence of debt or other instrument defining the rights of such creditor, or a modification of the security, if any, for the claim of such creditor."

It must be conceded that, if the New York Central and the Big Four do not have the right to renew the Operating Agreement, then the Income Bondholders are adversely affected by the renewal of said Agreement. The provisions of the Operating Agreement supersede the provisions of the Income Mortgage as to the ascertainment of the interest, if any, payable on the Income Bonds, and the rights of the Income Bondholders are wholly controlled thereby. If there is no right of election on the part of the Big Four the Income Bondholders would not be subject or subordinate to any new Operating Agreement unless they consented thereto.

Even assuming the right to renew the Operating Agreement for a further period of twenty years, the New York Cen-

tral and the Big Four have elected to renew the Operating Agreement, not upon the same terms and conditions as contain in the original agreement, but with certain modifications. The agreement evidencing the renewal of the Operating Agreement (Exhibit 33) provides that the guaranty with respect to the net earnings of the respondent shall be reduced from $412,200 to $188,892, an amount sufficient only to pay interest on the First Consolidated Bonds as reduced and extended under the Plan, and that all expenditures in connection with the replacements, additions and betterments shall be charged against the Peoria Company instead of assumed by the New York Central in accordance with paragraph First of the Operating Agreement.

The renewal of the Operating Agreement with the modifications hereinabove set forth is a modification of an instrument defining the rights of the Income Bondholders, and adversely affects their interests.

The Special Court found that the Income Bondholders were not affected by the Plan (Findings of Special Court No. 41). For the reasons hereinabove set forth, it is respectfully submitted that the written consent of the Income Bondholders should have been secured in the manner provided in Sections 710 and 725 of Chapter XV, as their interests are adversely affected by the Plan of Adjustment.

POINT E

The Special Court erred in finding that the Plan was fair and equitable as an adjustment; afforded due recognition and fair consideration to the Income Bondholders; and conformed to the law of the land regarding the participation of the various classes of creditors.

Chapter XV requires as a condition to the approval of the Plan that it shall be found "in the public interest and *in the best interests of each class of creditors* and stockholders" (Sec. 710), and "that the plan is fair and equitable as an adjustment, affords due recognition to the rights of each class

of creditors and stockholders and fair consideration to each class thereof adversely affected and will conform to the law of the land regarding the participation of various classes of creditors and stockholders" (Sec. 725).

The Plan of Adjustment, as promulgated by the New York Central through its wholly controlled and dominated subsidiary the Peoria Company, does not comply with the foregoing provisions with respect to the interests of the Income Bondholders.

It is estimated that, assuming the continuance of the general basis of earnings and expenses which prevailed in 1939, the Peoria Company should show a corporate income for 1940 of $304,727 which is to be applied as follows: $188,892 for interest on the First Consolidated Bonds as reduced and $83,000 for interest to the New York Central at the rate of 6% on account of its alleged advances (Exhibit 41). The balance thereof will be used to reduce the principal amount of these advances. In no event, however, by reason thereof, will the Income Bondholders receive any interest for the next twenty years.

On the foregoing estimates the New York Central will not be required to advance any money on account of its guarantee of interest to the First Consolidated Bondholders as the earnings will be ample to pay same. The New York Central will be receiving all the benefits derived from the Operating Agreement without paying any consideration therefor.

Such an adjustment is not in the best interests of the Income Bondholders and does not afford to them due recognition and fair consideration.

The Plan of Adjustment does "not conform to the law of the land regarding the participation of the various classes of creditors and stockholders" as enunciated in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106.

In the instant case, priority is given to the New York Central and the Big Four for the repayment of their unsecured advances with interest at 6% out of the earnings of the Peoria Company (which advances under the Operating Agreement were not to be an obligation of the Peoria Com-

pany). In other words, recognition and priority is given to a doubtful unsecured non-negotiable debt over a secured negotiable debt. In addition, the stockholders of the Peoria Company (the New York Central owning 51% of the stock) receive undue favor and in effect are given priority to the Income Bondholders under the Plan by participating therein without any change in their status.

In truth and in fact the purpose of the Plan of Adjustment is not to aid the Peoria Company through a temporary financial embarrassment, but to subordinate the Income Bondholders to the interests of the New York Central in the Peoria Company, as represented by the Operating Agreement, its alleged advances and its majority stock ownership, for a period of twenty years.

POINT F

The Special Court erred in drawing inferences of fact, giving consideration to and being influenced by the threats of the New York Central that, in the event the Plan were not approved, it would withdraw its deposit of $5,000,000 in satisfaction of the Purchase Money Lien on the Springfield Division and would re-route its traffic therefrom over other lines, which would result in inevitable bankruptcy for the Peoria Company.

Counsel for the Peoria Company, speaking for the New York Central and the Big Four which he also represented, in his brief and in his oral argument in the Court below, repeatedly advised the Court that, if the Plan were not confirmed, the Big Four would probably withdraw its deposit of $5,000,000 for the satisfaction of the Purchase Money Lien on the Springfield Division and the New York Central would re-route its traffic therefrom over other lines controlled by it which would result in bankruptcy for the Peoria Company. That the Special Court was unduly influenced by these veiled

threats is indicated from the following excerpt from its opinion:

> "The New York Central probably will, and lawfully may, withdraw its deposit of $5,000,000 because the "Big Four" never undertook to pay the lien. That well may result in the foreclosure of the lien, and that in turn will subject the Springfield Division to the first consolidated mortgage since it covers the lien. But it is impossible now to say what in that event will be the net income of the two divisions, and how it will compare with the fixed charges. No present figures could throw any light upon that question because the result would be a dismemberment of the system; for the New York Central could route its freight by other rails, and might do so, if the bondholders, being in possession of both divisions, would not come to terms" (Appendix B, p. 48).

The Supreme Court in *Case* v. *Los Angeles Lumber Products Co., supra,* recently condemned such threats as employed by the New York Central:

> "The District Court's further finding that if the bondholders were to foreclose now they would receive 'substantially less than the present appraised value' of the assets of the debtor corporation is no support for inclusion of the old stockholders in the plan. The fact that bondholders might fare worse as a result of a foreclosure and liquidation than they would by taking a debtor's plan under §77B can have no relevant bearing on whether a proposed plan is 'fair and equitable' under that section. Submission to coercion is not the application of 'fair and equitable' standards" (p. 123).
>
> * * * * * *
>
> "Threats by stockholders of the kind here in question are merely threats to the jurisdiction of the court, which jurisdiction these selfsame stockholders invoked for their benefit when they caused the debtor's petition to be filed. Consequently, these claims of the stockholders are, as we have said, entitled to no more dignity than any claim based upon sheer nuisance value" (p. 130).

The writ of certiorari to the United States District Court for the Southern District of New York should be granted.

Respectfully submitted,

CHARLES S. ARONSTAM,
Counsel to Petitioners.

CHARLES S. ARONSTAM,
ARCHIE S. KARP,
of Counsel.